BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Investigation on the Commission's Own Motion to Determine Whether Pacific Gas and Electric Company and PG&E Corporation's Organizational Culture and Governance Prioritize Safety.	Investigation 15-08-019 (Filed August 27, 2015)

OPENING COMMENTS OF PACIFIC GAS AND ELECTRIC COMPANY (U 39 M) AND PG&E CORPORATION ON THE ASSIGNED COMMISSIONER'S SCOPING MEMO AND RULING

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TABLE OF CONTENTS

Page

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Pacific Gas and Electric Company (PG&E or the Utility) and PG&E Corporation[1] acknowledge the concerns expressed by the Commission and others regarding PG&E's safety culture. PG&E's most fundamental responsibility is to design, build, maintain, and operate its energy systems to keep customers and communities safe. We recognize we must do more to live up to that responsibility.

Over the last several years, PG&E has been working to enhance its safety culture. We also recognize that while we have made progress, we have more to do. For example, PG&E embraced all the recommendations of NorthStar in Phase I of this proceeding and is working to implement them. The PG&E Corporation Board of Directors recently announced that it currently expects that no more than five of PG&E Corporation's current directors will stand for election at the 2019 Annual Meeting of Shareholders, and that it intends that a majority of PG&E Corporation's directors will be new independent directors by the time of the 2019 Annual Meeting, subject to proper consideration of new candidates. Subject to applicable regulatory

[1] PG&E Corporation is participating as a respondent in I.15-08-019 and wishes to engage constructively with the Commission and stakeholders, consistent with the Commission's limited jurisdiction over PG&E Corporation. *See PG&E Corp. v. Public Utilities Comm'n*, 118 Cal. App. 4th 1174 (2004).

approvals, it is expected that PG&E's Board will track the new composition of PG&E Corporation's Board. A number of senior executives have left PG&E and PG&E Corporation.

PG&E welcomes input from other stakeholders and guidance from the Commission as to how PG&E can further develop its safety and oversight processes. PG&E is open to considering further changes to its Board, management, governance, and structure that could further improve its safety performance. PG&E is committed to thoroughly evaluating the proposals put forth in the Assigned Commissioner's Scoping Memo and Ruling, and has not pre-determined a preferred outcome of this effort.

This proceeding comes at a time when PG&E and PG&E Corporation have commenced reorganization proceedings under Chapter 11 of the U.S. Bankruptcy Code. In the Chapter 11 cases, PG&E and PG&E Corporation will work to develop a plan for restoring financial health, including resolving liabilities arising from the 2017 and 2018 wildfires, while continuing to improve the safety and reliability of PG&E's services. Coordinating this proceeding with the Bankruptcy Court process will be important, because some of the ideas for improving governance, structure, and operations developed during this proceeding may implicate matters within the jurisdiction of the Bankruptcy Court. Further, in this proceeding, the interests of the Commission and stakeholders may diverge in some respects from the interests of parties to the Chapter 11 process, underscoring the need for close coordination.

Additionally, some of the Scoping Memo's proposals will require coordinating with other proceedings before the Commission, such as the proceeding to implement Public Utilities Code § 451.2,[2] PG&E's general rate case,[3] and PG&E's upcoming cost-of-capital proceeding. Some of the proposals, if implemented, also would require changes to California statutes, necessitating action by the Legislature. PG&E looks forward to working with the Commission and all parties on these complex and inter-related matters.

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[2] R.19-01-006 (Jan. 18, 2019).

[3] A.18-12-009 (Dec. 13, 2018).

I. EXECUTIVE SUMMARY

- PG&E supports the Scoping Memo's scope for Phase II: "consider[ation of] a broad range of alternatives to current management and operational structures for providing electric and natural gas in Northern California."[4] PG&E also supports using the eight criteria identified in the Scoping Memo for evaluating such alternatives. PG&E will work constructively with the Commission and other parties to explore all proposals that can improve the public and workforce safety of its gas and electric systems.

- PG&E and PG&E Corporation have already pursued a number of the proposals in the Scoping Memo, including changes to their respective Boards of Directors and management.

  - On January 4, 2019 and February 11, 2019, PG&E Corporation announced significant changes to its Board. The PG&E Corporation Board expects that no more than five of PG&E Corporation's current directors will stand for election at the 2019 Annual Meeting of Shareholders, and it intends that a majority of PG&E Corporation's directors will be new independent directors by the time of the 2019 Annual Meeting, subject to proper consideration of new candidates. Subject to applicable regulatory approvals, it is expected that PG&E's Board will track the new composition of PG&E Corporation's Board.

  - PG&E and PG&E Corporation also have made significant changes to their management, including the January 2019 departures of PG&E Corporation's Chief Executive Officer Geisha Williams and PG&E's Senior Vice President, Electric Operations Patrick Hogan.

  - PG&E's and PG&E Corporation's Boards consider safety in their decision-making, rely on an independent PG&E Corporation nominating committee for directors, consider safety expertise in selecting directors, and incorporate safety as part of incentive compensation.

  - PG&E looks forward to input from stakeholders and parties on how it can improve in these and other areas.

- PG&E is open to exploring a range of additional proposals to enhance its governance and management, if such changes would improve PG&E's safety performance.

  - While structural changes do not directly alter the overall exposure, drivers, frequency, and consequences of a utility's risks, changes in corporate

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4 Assigned Commissioner's Scoping Memo and Ruling at 8 (Dec. 21, 2018) (Scoping Memo or ACR).

structure have the potential to improve how risks are managed and overseen. The Commission and parties should evaluate further, based on data, whether and to what extent various structural alternatives would improve risk management.

- At the same time, structural changes can present a number of practical, operational, financial, and legal challenges, including potential dilution of enterprise-wide expertise and risk management, dis-economies of scale, and one-time and ongoing incremental costs that could undercut efforts to fund wildfire liabilities and emerge from the Chapter 11 proceedings in a strong financial position. The complexity of certain structural changes also could require significant time and attention from management, which could have the unintended consequence of diverting attention from the critical task of risk mitigation.

- PG&E supports (and has already proposed) linking return on equity to safety performance.

- PG&E urges the Commission to continue working collaboratively with the Legislature to reform the flawed legal doctrine of inverse condemnation liability for wildfires and to pursue other legal and policy changes that will mitigate utilities' financial exposure to future wildfires—particularly in cases in which the financial exposure arises from the strict liability standard. Absent such comprehensive reform, the financial viability of all California electric utilities will continue to be threatened, which will undermine their ability to provide safe and reliable service, and render inadequate any changes resulting from this proceeding, however meritorious such changes may be.

II. SCOPE AND PROCESS

The Scoping Memo invites "comment on scope and process" for Phase II.[5] PG&E broadly supports considering the topics identified in the Scoping Memo and the eight factors identified for evaluating potential alternatives. Those factors are: (1) the safety and reliability of utility service; (2) the operational integrity and technical unity of components within PG&E's gas and electric transmission and distribution systems; (3) the stability and adequacy of PG&E's workforce; (4) PG&E's relationship with and role in local communities; (5) the ability of the State to implement its energy policies, including reducing greenhouse gas emissions and local criteria pollutants in the utility sector and the economy as a whole; (6) the ability of PG&E to meet financial challenges posed by catastrophic events such as earthquakes and wildfires;

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[5] Scoping Memo at 13.

(7) PG&E's ability to raise capital and purchase gas, electricity, equipment, and services; and (8) the cost of utility service.[6]

As part of the Commission's consideration of how proposed changes to PG&E's corporate governance, board management, and structure would affect PG&E's safety culture, PG&E suggests that the Commission consider how such changes could be integrated into PG&E's risk management and how they could improve the ongoing development of PG&E's Enterprise Safety Management System (ESMS).

Regulators and businesses in high-risk industries have recognized the importance of systemic approaches to risk management. A safety management system can identify, evaluate, and direct mitigation of risks, and also address safety issues that may be difficult to quantify—particularly safety culture, management, and leadership.[7] In the years following the San Bruno tragedy, PG&E developed and implemented a safety management system for the design, construction, maintenance, and operation of its natural gas system. While the details regarding the measures already implemented by PG&E in this regard are beyond the scope of this submission, PG&E has been working to extend its safety management system to the remaining elements of the enterprise, with a comprehensive program to address public safety (asset integrity), workforce safety (occupational health and safety), environmental management, and safety culture (management and governance). PG&E's enterprise safety management system will include PG&E's overall safety policy, goals and objectives; the governance and management structure for safety; leadership authority and responsibilities; senior leaders' commitment to and accountability for safety; and risk assessment and management. Phase II, which includes consideration of possible changes to corporate governance, management, and

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6 *Id.* at 12-13.

7 *See* R. Kennedy et al., *Development of a Hazard and Operability-Based Method for Identifying Safety Management Vulnerabilities in High Risk Systems*, 30 Safety Science 249, 250-51 (1998) ("[S]afety culture is … abstract and is often relatively intangible. The approach, therefore is to focus on safety management practices, as these are tangible, measurable and observable, and will mediate safety culture problems and deficiencies.").

structure, has the potential to affect the design, development, and ultimate success of PG&E's enterprise safety management system.

The Commission's regulatory approach can significantly impact the development of a healthy safety culture. Regulatory action should promote effective self-evaluation and cultural improvements by creating an environment that is focused on continuous improvement, speaking up, and learning. The NorthStar report, for example, lists as one of its "critical recommendations" a "non-punitive system for reporting actual and potential safety incidents to the CPUC to encourage reporting and facilitate lessons learned."[8] Similarly, in the safety-critical field of aviation, the Federal Aviation Administration (FAA) emphasizes "Safety Assurance" rather than "Compliance and Enforcement," so as to ensure transparency and constructive approaches to identifying and addressing safety issues.[9] The FAA also has collaborated with NASA to establish the Aviation Safety Reporting System founded on the principle of non-punitive reporting, going so far as to offer limited immunity to the reporter.[10] The purpose of fostering this type of safety culture is not to be lax on discipline; rather, it is to encourage all stakeholders to relentlessly identify and fix systemic risks to the public and workforce. PG&E is committed to creating such an environment.

In the past several years, stakeholders have taken a transparent, inclusive, and constructive approach that has resulted in systematic and substantive advances in risk management for California utilities. The collaborative approach to the Risk Assessment

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[8] Scoping Memo and Ruling of Assigned Commissioner, Attachment: Assessment Of Pacific Gas And Electric Corporation And Pacific Gas And Electric Company's Safety Culture Prepared For California Public Utilities Commission ("NorthStar Report") at I-10 (May 8, 2017); *see also* Scoping Memo at 9 (commenting that Phase 2 "is not a punitive exercise").

[9] Federal Aviation Administration, Aviation Safety (AVS) Safety Management System Requirements (May 09, 2017) at 3, 17-19, available at https://www.faa.gov/documentLibrary/media/Order/VS_8000_367B.pdf.

[10] FAA Aviation Safety Reporting System Advisory Circular 00-46E, "Immunity Policies" (Dec. 16, 2011), available at https://asrs.arc.nasa.gov/overview/immunity.html.

(footnote continued)

Mitigation Phase (RAMP) of the General Rate Case (GRC) proceeding, the Safety Model Assessment Proceedings (S-MAP), and PG&E's internal Multi-Attribute Value Function (MAVF) development processes and methodologies helped align all parties in the best approaches for identifying, assessing, measuring, and mitigating risks that inhere in operating utility assets in California.[11] Risk management is an integral part of any safety management system, and PG&E fully supports the approach and advances in risk management led by the Commission. PG&E urges the Commission to consider how the proposals considered in Phase II of this proceeding will impact PG&E's overall management of risks and continued development of its enterprise safety management system.

III. CORPORATE GOVERNANCE AND CORPORATE MANAGEMENT

PG&E welcomes input on how the Board and senior management can further improve oversight regarding safety performance. In general, such changes would be aligned with the criteria identified in the Scoping Memo, including: improving operations and reliability; promoting a stable and qualified work force; helping to rebuild PG&E's relationships with local communities; enabling PG&E to work with the state to implement our energy policies; allowing PG&E to operate efficiently and provide service at reasonable rates; and, in conjunction with other changes to inverse condemnation, helping to restore PG&E's financial health and put it in a better position to withstand future financial disruptions.[12] In evaluating different corporate governance structures, it will be important to review data to understand what correlations, if any, different structures have on key areas of performance. Below, PG&E offers its perspective on the Scoping Memo's suggestions regarding potential changes to PG&E's governance and management.

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[11] *See* D.14-12-025, at 1-3 (Dec. 9, 2014) (RAMP); D.16-08-018 at 173 (Aug. 29, 2016) (S-MAP).

[12] *See* Scoping Memo at 12-13.

A. PG&E's Comments On The Scoping Memo's Suggestions

1. Should PG&E and PG&E Corporation be subject to a utility-specific business judgment rule (BJR) to require the Board of Directors to account for safety beyond the current fiduciary duties? If so should such a business judgment rule apply to corporate officers as well?

PG&E supports Proposal 1 insofar as it suggests exploring changes that would further enhance directors' and officers' consideration of safety as part of effective corporate governance. However, the Boards of PG&E and PG&E Corporation view oversight of safety of operations as not only essential but also consistent with their existing fiduciary duties to ensure that each company is operated to protect and enhance the economic interest of stakeholders, which are defined by the California Corporations Code.

Modifications to the existing statutory business judgment rule, however, could have unintended adverse impacts on safety culture, and may not be legally feasible. The business judgment rule provides, among other things, that directors can rely in good faith on information provided by management and advisors—including with respect to safety.[13] Limiting liability for good faith reliance on professional opinions encourages the Board to engage with subject matter experts. Conversely, altering the business judgment rule to expose directors to personal liability for management's safety-related decisions may create incentives for directors not to rely on experts or management, which would weaken—not strengthen—Board level oversight for safety matters. Directors would also be further exposed to the threat of frivolous litigation. Any change to the business judgment rule would engender more litigation and consume years of judicial resources to arrive at a well-defined rule. After-the-fact second-guessing fosters a climate of fear and silence rather than the open discussion of safety that is a fundamental attribute of a strong safety culture.

PG&E is also concerned that altering the well-established and well-known business judgment rule would hurt its ability to recruit and retain qualified directors, by, among other

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[13] Cal. Corp. Code § 309.

(footnote continued)

things, increasing uncertainty and potential exposure to personal liability.[14] Chilling efforts to recruit highly qualified Board members would be counter-productive for PG&E and its stakeholders and hinder the development of innovative responses to safety and operational concerns.[15] These concerns apply with equal force to the Boards of PG&E and PG&E Corporation, as well as management. Effective governance requires recruiting and retaining the most qualified board and management candidates.

As noted, PG&E also has concerns about the legal feasibility of modifying the business judgment rule. The business judgment rule is codified in California Corporations Code § 309, which is not administered by the CPUC. PG&E does not believe the CPUC has the authority to change the application of this statute in proceedings that are not before the Commission.

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[14] *See* Edward Rock & Michael Wachter, *Dangerous Liaisons: Corporate Law, Trust Law, and Interdoctrinal Legal Transplants*, 96 Nw. U. L. Rev. 651, 659–60 (2002); Expert Report of John C. Coffee, *In re PHAR-MOR, Inc. Securities Litig.*, 1996 WL 33689524 (W.D. Pa. 1996) ("[A]s noted above… increased fear of exposure to liability [together with other factors] is already making it harder to recruit top director candidates and is leading to concerns about excessive risk aversion in corporate decision-making."); *Air Line Pilots Ass'n, Int'l v. UAL Corp.*, 717 F. Supp. 575, 582 (N.D. Ill. 1989) (observing that "[i]t would be considerably more difficult to recruit directors to serve on corporate boards if their business decisions were subject to substantive scrutiny"), *aff'd*, 897 F.2d 1394 (7th Cir. 1990); Emily S. May, *Bank Directors Beware: Post-Crisis Bank Director Liability*, 19 N.C. Banking Inst. 31, 48–49 (2015) ("[I]ncreased risk of personal liability may also make it difficult for companies to recruit qualified directors. A recent survey of 2,000 banks and savings institutions stated that in the past five years, 24.5% of respondents said that they had a director resign or refuse to serve on the board itself or on the board's bank loan committee due to fear of personal liability.").

[15] Jay A. Conger and Edward Lawler III, *Building a High-Performing Board: How to Choose the Right Members*, 12 Business Strategy Review 11 (2001) (discussing the importance of recruiting directors with appropriate expertise to board performance generally).

2. Should the PG&E Board of Directors regularly file with the Commission a report of how the Board met its duties under the BJR to account for safety? Should this include a summary of the oversight exercised by the Board including information reviewed, when deliberations occurred, and the depth of review? Should the report include the Board review of the corporate officers' leadership as it pertains to safety? Should compensation to the Board Members be dependent on a Commission finding that the Board members discharged their safety duties appropriately?

PG&E supports consideration of Proposal 2 and believes that additional reporting may help improve the further development of its enterprise safety management system. Currently, the Boards of PG&E and PG&E Corporation receive a briefing from the companies' Chief Safety Officer at every regularly scheduled meeting of the Boards' Safety and Nuclear Oversight (SNO) Committees. The SNO Committees and the full Boards review safety metrics and any serious incidents that the Chief Safety Officer concludes merit SNO Committee and/or full Board attention. PG&E has previously provided the Commission with materials provided to the SNO Committees and/or the Boards regarding safety metrics, serious incidents, and other safety matters. PG&E does not object to providing such materials to the Commission on a regular basis.

PG&E is also open to changing the way it reports to the Commission on Board-level safety-related decisions, including reporting to the Commission about the review of senior leadership as it pertains to safety.[16]

As in Phase I, PG&E recommends that the Commission focus any reporting on the process for review, rather than the reviews of individual members of the management team.

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[16] While PG&E does not believe the Commission has jurisdiction to impose a reporting requirement directly on the Board of PG&E Corporation, to the extent meetings of the Boards (or Committees of the Boards) of PG&E and PG&E Corporation are jointly attended by members of both Boards, PG&E would be willing to report on such meetings, in order to ensure full transparency from both PG&E and PG&E Corporation.

PG&E has long worked to continuously improve its oversight and decision-making processes and has redoubled those efforts in the wake of the serious safety incidents of 2017 and 2018. PG&E's reporting on its progress in implementing NorthStar's recommendations provides a model for a revised reporting approach. Process-based reporting is more likely to facilitate meaningful insight into corporate oversight. Process-based reporting also mitigates issues with the privacy interests of individual managers and the potentially chilling effect that non-process-based reporting could have on discussions of safety and on recruitment.

Finally, PG&E supports examining whether and how to more closely link Board compensation to safety performance, but has concerns about the suggestion that Board compensation would depend on a Commission determination that the directors have discharged their safety duties. PG&E believes that this proposal would divert resources away from more effective methods of ensuring safety and Board accountability, and will make it harder to attract and retain qualified directors. To the extent the proposal would extend to directors of PG&E Corporation, the proposal would exceed the Commission's authority.

3. Should PG&E form an independent nominating committee to identify and select candidates for the Board of Directors?

The Board of PG&E Corporation currently has a Nominating and Governance Committee that oversees director nomination and selection for both PG&E and PG&E Corporation. This committee is comprised entirely of independent directors (as defined and as required under New York Stock Exchange rules). On February 11, 2019, the Board of PG&E Corporation issued a news release with updates on its previously announced Board refreshment process.[17] The Board currently expects that no more than five of PG&E Corporation's current directors will stand for election at the 2019 Annual Meeting of Shareholders. The Board intends that a majority of the

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[17] PG&E Corporation News Release, PG&E Provides Updates on the Board Refreshment Process (Feb. 11, 2019) available at http://investor.pgecorp.com/news-events/press-releases/press-release-details/2019/PGE-Provides-Update-on-Board-Refreshment-Process/default.aspx.

directors of PG&E Corporation will be new independent directors by the time of the 2019 Annual Meeting, subject to proper consideration of new candidates. The Board is expected to include 11 independent directors at that time. Subject to applicable regulatory approvals, it is expected that the Board of Directors of PG&E will track the new composition of PG&E Corporation's Board. The Board is working with a leading search firm and has identified strong candidates who would add fresh perspectives and augment the Board's expertise in safety, operations and other critical areas.

Because PG&E Corporation already has an independent Nominating and Governance Committee, there does not appear to be a need for additional Commission action in this area. If the Commission were to consider further action, it would need to ensure that any changes comply with all applicable stock exchange governance and independence requirements, including those promulgated by the New York Stock Exchange. In particular, the stock exchange rules include composition and constitution requirements (including independence) for a committee that identifies and selects directors consistent with board-approved criteria.

4. Should PG&E identify specific criteria for potential Board of Directors members? For example, should PG&E have one or more Board of Directors be experts in organizational safety, gas safety, and/or electrical safety? If so, should the appointment of safety experts be made subject to Commission or Governor approval?

PG&E and PG&E Corporation already have a comprehensive matrix of director skills, reflecting operational, safety, customer, community, climate, energy policy, and financial priorities, which allows the Board to bring varied expertise to bear.[18] The PG&E Board has had an independent Chair since 2008. In 2017, the PG&E Corporation Board appointed an independent non-executive Chair to further safeguard independent Board oversight. And following the San Bruno tragedy, in 2011 the PG&E Corporation Board established the Nuclear, Operations, and Safety Committee (this committee was later renamed as the Safety and Nuclear

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[18] *See* I.15-08-019, Summary of Corporate Structure of Pacific Gas and Electric Company (U 39 M) and PG&E Corporation, Attachments 1 and 4 (Jan. 16, 2019).

Oversight Committee and a parallel committee of the PG&E Board was established as well). The Boards of PG&E and PG&E Corporation also added new directors with utility operational experience, and in December 2017 explicitly specified that safety experience was a skill or characteristic that the Boards consider when assessing director candidates. PG&E and PG&E Corporation are open to supplementing these changes and, as noted, PG&E and PG&E Corporation are currently recruiting Board candidates.

PG&E is concerned, however, about the feasibility, effectiveness, and lawfulness of conditioning the appointment of safety experts on Commission or Governor approval. Under California law, the shareholders of a corporation have the right to elect directors.[19] Companies, in consultation with their independent directors, identify and nominate directors; if shareholders believe that the nominees are not suitable, they can nominate alternative candidates, and shareholders ultimately are the ones who elect the directors.[20] Conditioning nominations on Commission approval would undermine shareholder rights and create a conflict with basic corporate law. In the long term, requiring Commission or Governor approval has the potential to politicize certain Board positions, reduce PG&E's and PG&E Corporation's flexibility to appoint Board members with extensive industry experience, and hinder recruitment. This proposal also would be unprecedented. PG&E is not aware of any example of regulator or Governor approval for Board appointments. As such, there is no record to indicate the effectiveness, feasibility, or unintended consequences of such a requirement.

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[19] *See* Cal. Corp. Code § 305(b).

[20] *See Stephenson v. Drever,* 16 Cal. 4th 1167, 1176 (1997) ("At shareholders' meetings each shareholder is entitled to offer proposals to be voted on and to vote on proposals presented by management, and to nominate directors and to vote on the slate of directors nominated by management."); *see also* Cal. Corp. Code § 708; Lawrence A. Hamermesh, *Director Nominations*, 39 Del. J. Corp. L. 117, 118 (2014) (noting that "the power of shareholders to elect the corporation's directors is widely viewed as an important disciplinary tool to limit agency costs and to facilitate beneficial changes in corporate control").

5. Should PG&E form an audit committee constituted of independent directors possessing financial and safety competence, as defined by the Commission, to evaluate the Board of Directors' discharge of their duties and make recommendations for qualifications of future members of PG&E's Board of Directors?

The Boards of PG&E and PG&E Corporation each have an Audit Committee tasked with overseeing and monitoring PG&E's financial statements, financial and accounting practices, internal controls over financial reporting, legal and regulatory compliance, risk assessment guidelines and processes, and other matters. All of the members of the Audit Committees are independent directors, as defined and as required by New York Stock Exchange as well as Securities and Exchange Commission rules promulgated under the Securities Exchange Act of 1934 and the Sarbanes-Oxley Act of 2002.

PG&E would be willing to consider expanding the Audit Committee's charter to consider the full Board's discharge of its safety duties. PG&E also would be willing to consider requiring the Audit Committee to recommend qualifications of Board members, though this currently falls within the jurisdiction of the PG&E Corporation Nominating and Governance Committee. PG&E notes, however, that imposing these additional responsibilities on the Audit Committees could have unintended negative consequences. The Audit Committees of PG&E and PG&E Corporation are subject to numerous duties prescribed by law relating to oversight of the financial statements and the independent auditor. Further, members of the Audit Committees already must be "financially literate" and, in some cases, be "financial experts."[21] If the Audit Committees were to assume additional duties relating to director nominations or safety, it may be difficult to recruit candidates who have both the currently required financial literacy and experience in governance or safety that would be necessary to perform the proposed additional Audit Committee duties. There are other Board committees that do not have the same obligations and hence have more time to address additional matters. As noted, the SNO

[21] *See* New York Stock Exchange, Listed Company Manual § 303A.07(a).

Committees also review safety metrics, serious incidents, and other safety matters. PG&E suggests that the SNO Committee may be better situated to take on these additional duties.

PG&E's independent Monitor provides additional review of the PG&E and PG&E Corporation Boards' performance. In February 2017, the United States District Court for the Northern District of California appointed the Hon. Mark R. Filip (ret.) of Kirkland & Ellis LLP as PG&E's Monitor for a 5-year period. Since December 2017, members of the Monitor's team have attended the majority of regularly scheduled Board meetings. They have also observed SNO Committee, Audit Committee, and Compliance and Public Policy (CPP) Committee meetings. The independent Monitor has made presentations to the PG&E and PG&E Corporation Boards and management about his observations and has met with independent directors in executive session without PG&E employees present. PG&E expects the Monitor and his team to continue engaging constructively with PG&E's and PG&E Corporation's employees, management, and Boards to help make PG&E a better company, including weighing in on governance structure and related duties.

6. The Securities and Exchange Commission requires publicly traded companies to file an 8-K Form when a material event occurs. Generally, an event is material if there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision. Should PG&E file an analogous safety report with the Commission when PG&E makes a significant decision regarding capital expenditures pertaining to safety, a change in management as it pertains to safety, or any other decision that may impact safety?

As stated in response to Proposal 2, PG&E supports considering additional reporting to the Commission, including reporting on changes in management that relate to safety. Such reporting requirements would have to be clearly defined, in that nearly all of the decisions made by the PG&E Board have some relationship to safety. PG&E proposes that any reporting mechanism the Commission ultimately adopts supplement PG&E's existing reporting to avoid unnecessary duplication. PG&E currently provides information about "deferred work," or changes between planned and actual spending as part of its GRC process. The recent S-MAP

decision outlines how investment decisions in risk reduction should be evaluated and requires PG&E to state whether it spent what it said it would, whether it achieved the risk reduction it forecasted, and if not, why not.[22]

7. Should PG&E file a public annual report of all Directors and Officers insurance policies obtained by PG&E and identify the risk PG&E identified to obtain the insurance? If PG&E amends its Directors and Officers insurance, should it notify the Commission of the risk identified and the terms of the amended policy?

Directors and Officers (D&O) insurance policies are customary and essential to recruit and retain directors and officers. While as a conceptual matter PG&E does not oppose providing the Commission with an annual report on its D&O insurance policies and amendments thereto, it is concerned that public disclosure of this information could further incentivize litigation. PG&E acquires D&O insurance for claims alleging wrongful acts, including breach of fiduciary duty, and not because of any other specific risks.

8. Should part or all of the existing Board of Directors resign and be replaced by directors with a stronger background and focus on safety?

As noted above, PG&E and PG&E Corporation are currently undertaking a Board refreshment process. The PG&E Corporation Board recently announced that it currently expects that no more than five of PG&E Corporation's current directors will stand for election at the 2019 Annual Meeting of Shareholders, and that it intends that a majority of PG&E Corporation's directors will be new independent directors by the time of the 2019 Annual Meeting, subject to proper consideration of new candidates. The PG&E Corporation Board is working with a leading search firm and has identified strong candidates who would add fresh perspectives and augment the Board's expertise in safety, operations, and other critical areas. PG&E and PG&E Corporation have long been focused on operational and safety expertise in Board recruiting and are especially so in the ongoing refreshment process.

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22 *See* D.18-12-014 at 4-5 (2018).

9. Should PG&E retain new corporate management in all or in part?

PG&E's corporate management has changed significantly in the past few years, including recently. In the wake of the San Bruno tragedy, PG&E and PG&E Corporation separated the gas and electric functions and appointed a new leadership team for the gas business, recruiting candidates from inside and outside the company. In the last year, PG&E and PG&E Corporation have refreshed the entire electric operations leadership team, again recruiting candidates from inside and outside the company. A number of PG&E and PG&E Corporation officers have retired or left the companies recently, including PG&E Corporation Chief Executive Officer and President Geisha Williams, PG&E Senior Vice President of Electric Operations Patrick Hogan, PG&E Vice President of Electric Asset Management Kevin Dasso, PG&E Vice President of Electric Transmission Operations Gregg Lemler, and PG&E Vice President, Safety and Health and Chief Safety Officer John Higgins. PG&E and PG&E Corporation are open to considering further changes as appropriate. However, PG&E suggests that the Commission weigh the impact that additional changes to management might have on the stability of the leadership team. While PG&E believes that changes to leadership are important, it recommends weighing that interest against the importance of maintaining a cohesive leadership team and ensuring there are sufficient experienced executives with knowledge of the challenges that PG&E faces.

10. Should the questions posed above for Corporate Governance be similarly considered for corporate management?

Yes, consistent with the answers provided above. In addition, proposals for changing compensation would need to comply with California statutory requirements on payment of compensation.[23] There are also legal requirements pursuant to which certain officers must have specific expertise or training, which might conflict with additional requirements from the Commission on the selection of management.[24]

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23 *See, e.g.,* Cal. Labor Code § 221.

24 *See, e.g.,* 15 U.S.C. § 7241 (Sarbanes-Oxley Act § 302) (certification requirements relating to Chief Executive Officers and Chief Financial Officers); The NorthStar Report at IV-24 (NorthStar (footnote continued)

11. **Should compensation for non-officer executives be modified? Does the current incentive structure properly incent PG&E decision-makers?**

PG&E supports examining compensation in general and Proposal 11 in particular. Benchmark data shows that, historically, PG&E led peer utilities in the weight it assigned to safety in incentive compensation. Safety was weighed at 50% in its Short Term Incentive Plan (STIP) and 10% in its Long Term Incentive Plan (LTIP). Both of these weights led the industry. PG&E is currently evaluating its incentive compensation programs going forward and would be open to discussing modifications with the Commission (subject to Bankruptcy Court approval).

This topic is also under consideration in parallel proceedings. In response to the NorthStar Report, PG&E has committed to continuing to evaluate the link between safety and incentive compensation. And, in the 2017 GRC process, the Commission ordered that issues relating to safety and compensation should be litigated in PG&E's 2020 GRC.[25] PG&E has submitted testimony on that topic in A.18-12-009.[26] To ensure an efficient use of resources, PG&E suggests coordinating the treatment of this issue to avoid the submission of redundant testimony or duplicative analysis of this issue.

IV. CORPORATE STRUCTURE

A. Introduction

Any discussion of the effect of corporate structure changes on a utility's safety and performance must recognize that the exposure, drivers, frequency, and consequences of risks remain unchanged, regardless of corporate structure or ownership of utility operations. Whereas changes to corporate governance and management have the potential to directly affect safety, changes to corporate structure can affect safety risks only indirectly and, in some cases, may simply shift risk from one legal entity to another. For instance, a gas-only entity would not be

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Consulting Group recommendations regarding qualifications and training for the Chief Safety Officer).

25 D.15-09-001 at 176 (May 18, 2017).

26 A.18-12-009, Ex. 8, Ch. 4A (Dec. 13, 2018).

exposed directly to the risks associated with electric operations but those risks would nevertheless still exist and still directly impact the electric business. There are, however, certain corporate structures that may prove better for implementing and overseeing a comprehensive enterprise risk management system and thus positively affect safety performance. An evaluation of alternative structures should consider both the potential benefits as well as the time and resources required to implement and align those new structures.

Two broad themes are relevant to evaluating the potential indirect effects of alternative structures on enterprise risk management. The first is scale. The existing structure is responsible for mitigating risks across its entire service territory and using its resources to direct risk reduction activities to the areas within the service territory that have the highest risk. Larger utilities have better access to resources, and hence greater ability to raise capital, to attract and retain qualified workers, to develop expertise that can be deployed across the organization, and to invest those resources into reducing the probability of catastrophic events in the areas where they are most likely to occur. By contrast, prioritizing risks in a smaller organization may leave fewer resources available to address more significant risks in a different organization. While these considerations suggest that larger organizations may be financially better able to manage risk, there also is a school of thought that posits that integrated organizations can become too large to manage effectively. Hence, some have suggested that functionally separating PG&E into smaller business units may enable management of each unit to focus more intently on the safety risks of that unit. PG&E welcomes further exploration of these questions, including examination of data regarding the performance of utilities in relation to their size and scale.

A second theme is complexity. Some of the structural changes suggested in the Scoping Memo would present a number of practical and legal challenges. Structural changes, including reorganization and separation proposals, would involve significant cost inefficiencies, both one-time and ongoing. To enable new entities to provide utility service, the Commission would need to approve the transfer of assets, grant a certificate of public convenience and necessity to the new utility, and approve the issuance of stock and debt. A structural reorganization might also

involve potential waivers from affiliate transaction rules to permit the two entities to interact.[27] Bankruptcy Court approval of the transfer of assets outside the ordinary course would be required, and any such transaction would complicate and could delay PG&E's emergence from Chapter 11 proceedings. If new entities provide utility service, local franchises would need to be transferred and some of those franchise agreements require negotiations with individual municipalities or other jurisdictions. Other existing contracts, such as gas and electric procurement contracts, IT contracts, leases, licenses, land rights, and easements also would need to be assigned or modified to enable a new entity to provide service. Applicable federal, state, or local operating permits would need to be transferred to the new utility. The cost of borrowing for separate entities also could be higher than for a single entity.

Working through these issues would require considerable time and attention from management—attention that otherwise could be devoted to improving safety performance and advancing other priorities. This is not to say that structural changes should not be pursued, but only that the potential benefits of such changes and the timeframe for realizing those benefits should be weighed against the costs.

B. <u>PG&E's Comments On Suggestions Identified In The Scoping Memo</u>

12. Should PG&E's gas and electric distribution and transmission divisions be separated into separate companies? If so, should the separate companies be controlled by a holding company? Should the holding company be a regulated utility?

PG&E supports consideration of Proposal 12. Separation of PG&E's gas and electric operations appears feasible from a technical and operational perspective. The gas system and electric system are functionally independent from one another and each has its own operational control center. The separation of PG&E's gas operations from its electric operations has the potential to reduce the total risks managed by a single entity. This could increase operational focus by each entity and improve the development of each entity's safety management system.

[27] *See* D.06-12-029, Appendix A-3 (2006).

PG&E's preliminary opinion is that the separate gas and electric entities likely would be of sufficient scale to continue to respond to emergencies and would have sufficient expertise in the compliance and risk management functions.

Weighed against these potential benefits, separation implicates a number of challenges. In addition to the legal and practical issues associated with structural reorganization as summarized above, separating PG&E's gas and electric operations could increase rates. Separation could create incremental costs. These incremental costs would include one-time costs associated with the duplication of services that are currently shared, such as technology infrastructure, service centers, equipment storage, and billing and customer support. They also would include ongoing dis-synergies and dis-economies of scope associated primarily with increased headcounts in operations and asset management functions as well as the duplication of corporate services across separated entities, *i.e.*, human resources, fleet, finance, insurance, real estate, safety, environmental, health, legal, regulatory, etc.

One potential means of mitigating one-time and ongoing incremental costs would be to allow services to be shared through a parent holding company for the two entities. The Scoping Memo asks whether separate companies should be controlled by a holding company; PG&E believes that there are distinct advantages to retaining a corporate structure that includes a holding company parent. For example, consistent with the affiliate transaction rules, a holding company can provide certain corporate support services.[28] These include human resources, finance, regulatory affairs, legal, and pension management. Separating these corporate services would significantly increase both one-time and ongoing costs associated with any structural separation of gas and electric utility operations by inefficiently duplicating corporate functions.

The Scoping Memo further asks whether the holding company should be a regulated utility. In the case of a structural separation into gas and electric utilities, each entity would be a regulated utility. Any holding company would provide shared corporate support services and

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[28] *See* D.06-12-029, Appendix A-3, at 12 (Rule V.E).

oversee unregulated affiliates (to the extent there are any). But the holding company would not itself provide gas or electric service. As such, there would be no rationale or legal basis for regulating the holding company as a utility. The Commission approved PG&E's holding company structure in the holding company decisions.[29] It also adopted the affiliate transaction rules for all large energy utilities in California, which govern the relationship between a utility, a holding company, and their affiliates. These Commission decisions provide for robust oversight of the holding company by the Commission, including access to its books and records.[30]

While separation of PG&E's gas and electric operations would present a number of challenges, PG&E is prepared to explore this possibility with stakeholders and the Commission.

13. Should PG&E's corporate structure be reorganized with regional subsidiaries based on regional distinctions? For example, PG&E could be divided into multiple smaller utilities operating under a single parent company. If so, should such a reorganization apply to both gas and electric services? Do the physical characteristics of the gas and electric systems lend themselves to the same regional structure, or do the physical characteristics of the respective systems lend themselves to different regional structures?

While PG&E is not opposed to further consideration of Proposal 13, regional reorganization would be a lengthy, complex, and costly process that would require the investment of significant time and resources that may be more efficiently invested in safety and reliability initiatives with greater potential impact. To the extent there are benefits to regionalization, however, these could be achieved through a functional regional reorganization of PG&E while avoiding the complexity and costs associated with full legal reorganization.

It is not clear that regionalization would improve PG&E's safety performance. Whereas separation of gas and electric operations would divide risk by function, which has the potential to lead to improved matching of risk, resources, and operational focus, regionalization would divide

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29 *In re Pacific Gas & Elec. Co.*, D.99-04-068, 86 CPUC 2d 76 (Apr. 22, 1999) ("PG&E Holding Company Decision II"); *In re Pacific Gas & Elec. Co.*, D.96-11-017, 69 CPUC 2d 167 (Nov. 6, 1996) ("PG&E Holding Company Decision I").

30 *See* D.06-12-029, Appendix A-3, at 12 (2006) (Rule V.B).

common risks by geography and could lead to a skewed or heterogeneous allocation of risk and resources. As a primary example, the risk of catastrophic wildfires varies widely across PG&E's service territory, and regionalization likely would result in some regional entities facing significantly greater risk than others. It is also likely, given the diversity of the operating areas in PG&E's service territory and the distribution of risks, that the regionalized entities with the largest wildfire risks would have fewer employees and less financial strength to address and mitigate those risks.

Additionally, because each regional entity would conduct risk management limited to the particular geography it serves, regional disaggregation could undermine the benefits of enterprise risk management and lead to an inefficient use of resources. When risk management is performed on an enterprise basis, the enterprise can prioritize risks and potential mitigations on a comprehensive basis, increasing the effectiveness and efficiency of overall risk management throughout the system. In a regionalized system, by contrast, an individual entity might focus on reducing its highest perceived risks but those risks may be relatively minor when compared to the overall risks of affiliated utilities in the system. Devoting limited resources to reducing each entity's risks can crowd out more valuable investments that should be undertaken elsewhere. In other words, regional risk prioritization could reduce the resources deployed to address higher priority risks across the entire enterprise.

Splitting up PG&E into smaller entities also likely would produce adverse overall rate impacts. Regionalization would result in the loss of economies of scale as each regional entity would need to invest in infrastructure that PG&E currently shares across regions. For example, each regional entity would need a control center and a backup control center, which would cost at least $100 million per entity. Other functions that are currently consolidated (e.g., emergency response, compliance, risk assessment) also would need duplication. And increases in customer rates associated with separation could crowd out other uses of those revenues, such as making additional investments in safety and reliability.

In addition to the absolute increase in cost that a regional separation could produce, regional separation probably would result in significant rate increases in certain geographic areas. Each regional entity presumably would be responsible for its own financial health, would establish its own revenue requirement, and would bear its own liabilities. This is in contrast to the situation today, where many geographic areas are currently subsidized by other service regions. For instance, the cost of service can exceed the revenue collected in rural areas with low customer density, in urban areas with redundant and high cost infrastructure like underground distribution lines, in areas with higher density of CARE customers paying lower rates, or in areas with low average per customer usage driven by milder weather conditions. In many instances, there is a 30% to 50% difference between the revenue collected relative to the cost of service, even before accounting for anticipated future investments. These variances do not account for the generally greater wildfire risk faced by subsidized regions, which would bear a larger share of wildfire mitigation costs were they to become separate regional entities. As such, there would be significant equitable and distributional effects associated with regional separation of PG&E's electric system.

There also is the risk that smaller entities would lack the breadth of expertise and knowledge that can help improve safety and reliability. Smaller entities also may lack sufficient resources and expertise to respond to emergencies or to ensure compliance. To be sure, these concerns could be mitigated to some extent if the entities are allowed to share services to a significant degree, including for emergency response and the compliance function. However, as such sharing increases in scope, the entities collectively would begin to appear more similar to PG&E's current structure, thus diminishing the hoped-for benefits of smaller, more focused business units.

Smaller regional entities also may be more vulnerable to the financial impact of a major event given diminished access to capital due to their smaller size. While smaller regional entities likely would be able to raise the necessary capital to fund operations, these individual entities would have less capacity to absorb unexpected costs related to major events such as earthquakes,

landslides, and wildfires. An increase in unexpected costs could require a smaller entity to consistently issue debt or equity, affecting investor confidence and ultimately affecting customer rates as well.

Regionalization also would be complex from a technical and operational perspective. Initially, it likely would not be technically feasible to establish geographically coextensive gas and electric entities. PG&E's electric distribution and transmission systems are organized by regional planning area, whereas the gas distribution and transmission systems are designed around the hydraulic configuration of the gas system. Both the electric regional planning areas and the gas hydraulic configuration depend on key infrastructure that cannot easily be separated from transmission and distribution systems. The electrical regional planning areas and the gas hydraulic configuration do not align. A regional separation would probably require a separation between gas and electric systems as a first step.

Furthermore, even within electric operations, it would be difficult to establish coextensive regional entities for electric distribution and electric transmission. PG&E's electric distribution system is organized into eight regional areas of responsibility (AORs). Each AOR represents an area of control with one central authority with personnel, staff, systems, and workplaces to manage the grid. Electric transmission is organized into seven planning areas, which do not align with the AORs. The transmission system was designed and engineered at this planning area level, and future load capacity planning for the system also occurs at this level. Any separation that divided regional transmission planning areas would require an in-depth and costly engineering assessment to identify reconfiguration options that would maintain voltage stability. Creating regional electric entities along AOR boundaries would preserve operational flexibility and reliability, while in contrast, creating entities according to regional planning areas would maintain the technical system capacity.

Within gas operations, it similarly would be difficult to establish coextensive regional entities for gas distribution and gas transmission. The gas system is designed to maintain adequate pressure throughout the distribution and transmission lines. To allow continued gas

flow, operators must be able to feed lower-pressure pipelines from higher-pressure lines. Because the gas divisional boundaries are not aligned with the gas flow of the system, separating the gas system by region would require the establishment of new boundaries so that each entity could maintain adequate pressure independently of the others. While this may be technically feasible for gas distribution, it would not be technically feasible for the gas transmission backbone. The backbone consists of the largest diameter pipelines with gas flowing at the highest pressures. These pipelines feed gas across the entire system, so they need to remain integrated. And the backbone pipelines necessarily cross several of the geographic regions, so any separation would need to account for some system to maintain this cross-regional infrastructure.

It might be possible to overcome these technical challenges by creating multiple regional entities—for example, electric distribution entities organized by AOR, separate electric transmission entities organized by regional planning area, gas distribution entities organized by hydraulic configuration, a single gas backbone entity, etc. But the creation of multiple, smaller regional entities magnifies the risks of undermining enterprise risk management, increasing costs, and reducing expertise and financial strength.

Even more than a separation of the gas and electric businesses, regional reorganization would be complex, take considerable time to implement, and require extensive attention by management throughout the process, potentially diverting focus from other critical issues. These are important factors for the Commission to consider in evaluating whether adopting a regional separation proposal would be in the public interest.

14. Should the Commission revoke holding company authorization, so PG&E is exclusively a regulated utility? Should all affiliates and subsidiaries be spun off or incorporated into the regulated utility?

PG&E questions the inclusion of Proposal 14 because it is not clear that revoking the holding company authorization or spinning off non-regulated affiliates would increase safety. The Commission initially approved the formation of a holding company parent "because it

provides a corporate framework for the separate ownership of unregulated businesses and helps to insulate the credit of PG&E from the risks of ownership of such businesses."[31] At present, the holding company does have a few, primarily inactive, unregulated subsidiaries.[32] While there are no existing plans to use these entities, or any new entities, for unregulated operations in the foreseeable future, a holding company structure remains relevant if in the future PG&E Corporation elects to pursue unregulated businesses. As such, PG&E does not believe there is any reason or purpose for revoking the holding company authorization.

As noted above, the holding company structure allows for significant economies of scale and cost synergies through the provision of shared services. Retaining this structure is beneficial for any potential separation or reorganization of PG&E, whether as part of this proceeding or in the future. And, revocation of the holding company authorization could create significant legal, financial, and operational issues, including related to the CPUC's jurisdiction over the holding company, the transfer of shareholdings in the holding company to the utility, and the assignment or modification of other existing contracts with the holding company.

15. Should the Commission form a standing working group with the union leadership of PG&E to identify the safety concerns of PG&E staff?

PG&E supports consideration of Proposal 15 and would be open to having the Commission form a standing working group with the union leadership of PG&E. Alternatively, PG&E would welcome the attendance of Commission representatives at some or all of the

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[31] PG&E Holding Company Decision I, 69 CPUC 2d at 197.

[32] *See Response of Pacific Gas and Electric Company to Administrative Law Judge's January 22, 2019 E-Mail Ruling* at 1-2 (Jan. 29, 2019) ("PG&E National Energy Group, LLC, was a holding company, formed to hold equity interests in prior subsidiaries of PG&E Corporation and has no current activity or assets; PCG Capital, Inc., and Pacific Energy Capital IV, LLC, are or were investment vehicles that do not currently have investments or plans to make new investments; PG&E Corporation [Support] Services, Inc., provided general corporate support services in the past but has no current activity or employees; and PG&E Corporation [Support] Services II, Inc., currently has a total of 3 employees (2 salaried and 1 hourly) for permitted shared corporate support services, primarily to provide representation in Washington, D.C.").

(footnote continued)

forums that PG&E currently relies on for safety feedback and reporting from various levels of the company, including leaders, field staff, and union representatives.[33] PG&E also remains open to additional suggestions to the extent the Commission has other recommendations regarding reporting structures to identify safety concerns of PG&E staff.

16. Should some or all of PG&E be reconstituted as a publicly owned utility or utilities?

Proposal 16 raises a number of complex factual and legal considerations. In the United States, about 75% of customers are served by investor-owned utilities (IOUs), while 12% and 13% are served by cooperatives and municipal utilities, respectively.[34] Most IOUs have large, diverse service territories whereas 84% of cooperatives and municipal utilities serve under 50,000 customers in rural areas or small urban cores.[35]

This heterogeneity makes it difficult to draw reliable conclusions regarding any connections between an ownership model and safety performance. In addition, beyond industry-wide metrics, like System Average Interruption Duration, limited data are available.[36] Key differences exist, however, between the primary characteristics associated with each ownership model and the risk factors that each presents. In the following discussion, PG&E does not intend to suggest that one ownership model will invariably outperform the others, as there are examples of high-performing and low-performing entities of each type. Rather, PG&E identifies factors for the Commission to consider, including certain advantages of the IOU model.

IOUs in general, and PG&E in particular, have been effective in attracting and retaining a highly skilled workforce. While many government utilities likewise have skilled workers, some

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[33] These include the Enterprise Safety Council, the Line of Business Safety Councils, and the Line of Business Grassroots Safety Committees.

[34] Electric Industry Association, 2017 Form EIA-861 (Oct. 12, 2018) available at https://www.eia.gov/electricity/data/eia861/.

[35] *Id.*

[36] Due to proceedings like S-MAP, Commission-jurisdictional utilities lead the nation on public safety data.

(footnote continued)

may find it more challenging to attract and retain qualified workers, engineers, management staff and, particularly, senior leaders. Indeed, past studies of municipalization have found that "one of the most significant challenges municipal utilities faced was acquiring and building the knowledge base to operate the utility. Experienced personnel with knowledge of the electrical system were critical for a successful transition from the IOU to the municipal utility, and they were difficult to identify and hire."[37]

The ownership structure of IOUs creates incentives for safety. In an IOU model, management and the board are accountable to shareholders for the successful operation of the business.[38] Shareholders elect the board of directors, which in turn oversees management. If management fails to ensure that the company is operated safely and effectively, the company suffers negative financial consequences, as has been made apparent by the events of the last 18 months culminating in PG&E's filing for Chapter 11 reorganization. Safety failures led to reductions in the compensation of management and the Board, which ultimately face the prospect of loss of employment or Board membership. In fact, PG&E recently made a number of significant changes to management and, as part of the ongoing Board refreshment process, it is expected that a majority of directors of PG&E will be new independent directors by the time of the 2019 annual shareholder meeting. Conversely, when operations are successful, including from a safety perspective, superior management performance is rewarded.

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[37] Synapse Energy Economics, Inc., *An Analysis of Municipalization and Related Utility Practices*, at 3 (Sept. 30, 2017), available at https://doee.dc.gov/sites/default/files/dc/sites/ddoe/publication/attachments/An%20Analysis%20of%20Municipalization%20and%20Related%20Utility%20Practices.pdf.

[38] Filsinger Energy Partners, Inc., *Evaluation of Alternative Ownership Options for Electric Utility Assets on the Islands of Oahu and Hawaii,* Hawai'i Natural Energy Institute, Univ. of Hawaii (April 2016), at 16 ("[b]ecause investor-owned company management is accountable to equity owners, the profit motive . . . [is] pursued [alongside] the additional mandates of reliable service and cost-efficient power procurement"), available at https://www.hnei.hawaii.edu/sites/www.hnei.hawaii.edu/files/Evaluation%20of%20Alternative%20Ownership%20Options%20for%20Electric%20Utility%20Assets%20on%20Oahu%20and%20Hawaii.pdf.

(footnote continued)

IOUs also have an incentive to make prudent capital investments that promote safety and grid modernization, as they earn a return on investments approved by the regulator. Government utilities, by contrast, do not earn a profit. As a result, IOUs have stronger profit incentives to make investments that improve safety or quality of service.[39] For example, one study found: "Grid modernization investments fall into the class of facilities on which utilities can earn up to the authorized rate of return. This incentive predisposes utilities to favor investments over expenses, since they earn on investments but not on expenses."[40]

Some municipal utilities have excellent operating records. The absence of for-profit owners, however, can mean that there is no direct mechanism for ensuring operational excellence, and this can lead, on average, to greater inefficiency in the government utility sector as compared to IOUs.[41] Moreover, the Commission does not have general jurisdiction over government utilities, whereas the Commission exercises regulatory oversight of IOUs, with the assistance from and input of Commission staff and sophisticated intervenors. Lack of Commission oversight can mean less monitoring to ensure publicly owned utilities make well-

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39 Andrei Shleifer, *State Versus Private Ownership*, 12 J. Econ. Persp. at 133, 137 (Fall 1998).

40 Beecher, et. al., *Regulatory Incentives and Disincentives for Utility Investments in Grid Modernization*, Berkeley Lab Rep. No. 8, 80 (May 2017), available at http://ipu.msu.edu/wp-content/uploads/2017/09/LBL-FEUR-Regulation-and-Incentives-2017.pdf.

41 Dan Michael Berry, *Private Ownership Form and Productive Efficiency: Electric Cooperatives versus Investor-Owned Utilities*, 6 J. Reg. Econ. 399, 399 (1994) ("The empirical results suggest that the cooperative sector of the electric power industry produces its output in a much less efficient manner than does the investor-owned sector."); *see also* William L. Megginson & Jeffry M. Netter, *From State to Market: A Survey of Empirical Studies on Privatization*, 39 J. Econ. Lit., June 2001, 321, 380-81 (2001).

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informed decisions.[42] Indeed, this has the potential to hurt customers in the long term.[43] Whereas IOUs face the possibility of disallowances, forcing shareholders to bear certain costs associated with imprudence, a municipal utility passes its costs on to customers. There is no review or accountability and no shareholders to help defray any of the costs associated with potential missteps.

Government utilities are subject to political oversight. But such oversight is substantively different from the "relatively greater capacity and technical expertise" of state regulators, who "can recognize, establish, strengthen, codify, and enforce practice standards, imposing audits, fines, and penalties as necessary[, and establish u]niform rules and methods . . . [for] continuity, transparency, and accountability in accounting, reporting, and ratemaking across differently structured systems."[44]

The suggestion that the profit motive drives IOUs to underspend on safety-related operating expenses between rate cases is unfounded. Many safety-related operating expenses are tracked in one-way balancing accounts, including vegetation management,[45] gas transmission integrity management,[46] and engineering critical assessment.[47] Since the 2011 GRC, PG&E has

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[42] Synapse Energy Economics, *supra*, at 39 ("Munis are frequently not closely monitored by a public service commission, and inadequate auditing can allow poor decisions to multiply. . . . . Munis . . . have the flexibility to pursue other goals, and where leadership isn't consistent and wise, that can result in erratic decision making or the refusal to make a decision due to political concerns.").

[43] Filsinger Energy Partners, Inc., *supra*, at 18 ("[T]he lack of independent oversight from PUCs has the potential to result in more capricious and politically-driven actions, which might hurt ratepayers in the long-run.").

[44] Janice A. Beecher, *What Matters to Performance? Structural and Institutional Dimensions of Water Utility Governance*, 27 Int'l Rev. of Applied Econ. 150, 164 (April 2013).

[45] Electric Preliminary Statement Part BU, Vegetation Management Balancing Account, Cal. P.U.C. Sheet No. 33880-E (filed May 2, 2014).

[46] Gas Preliminary Statement Part CL, Transmission Integrity Management Program Balancing Account, Cal. P.U.C. Sheet No. 33081-G (filed Dec. 9, 2016).

[47] Gas Preliminary Statement Part DQ, Engineering Critical Assessment Balancing Account, Cal. P.U.C. Sheet No. 33205-G (filed Feb. 3, 2017).

reported the variance between budgeted and actual expenditures for capital and operating expenses. More recently, this reporting also has included any variance between the GRC approved forecast and actual expenditures, and has included granular detail (*i.e.*, material activity type code and not just major work category). And, pursuant to a settlement in its last GRC, PG&E also reports forecasted safety and reliability projects that were not pursued or completed. Even if PG&E spends less than its revenue requirement as established in a GRC, at most this can have a temporary, short-term effect, since the next GRC will use PG&E's *actual* expenditures over that period to forecast the revenue requirement for the subsequent period.

While government utilities have no profit-based incentive to underspend on safety, and some government utilities have excellent safety records, there is a risk that political and other factors that influence spending decisions can lead to inferior outcomes. For example, there is some evidence that publicly owned facilities tend to be less compliant with state and federal regulations.[48]

The process of potentially transitioning some or all of PG&E to a publicly owned utility would be complex, lengthy, and practically difficult to achieve. The California Constitution prohibits the State from becoming a direct shareholder of PG&E.[49] And a State takeover of PG&E's business would require authorizing legislation, while local government takeovers would not result in the municipalization of the entire PG&E system absent an unprecedented degree of cooperation by different jurisdictions.[50] Moreover, any taking of PG&E or its property would

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48 David M.Konisky and Manuel P. Teodoro, *When Governments Regulate Governments,* 60 Amer. Journal of Political Science 559, 572 (July 2016) (reporting "consistent evidence that publicly owned facilities are more likely than similar privately owned facilities to violate regulatory requirements" and that "enforcement officials [tended] to impose less severe punishment on public agencies violating the CAA and SDWA, when compared to similarly noncompliant private firms").

49 *See* Cal. Const. Art. 16, § 6 ("The Legislature . . . shall not have power to authorize the State, or any political subdivision thereof, to subscribe for stock, or to become a stockholder in any corporation whatever . . . .").

50 *See* Cal. Code Civ. Proc. § 1240.050 (generally limiting a public entity's eminent domain authority to "property within its territorial limits except where the power to acquire by eminent (footnote continued)

necessitate the payment of just compensation,[51] which would be a complex, lengthy, and potentially contentious process. Boulder, Colorado's "long-running municipalization attempt is both current and illustrative of many of the legal, economic, and technical challenges that could face a potential attempt to form a municipal or cooperative utility."[52] Even where the process is less contentious, it is still extremely difficult. The costs incurred by a public utility to acquire the system also can place "immediate and long-lasting upward pressure on rates."[53]

Furthermore, there would be significant costs associated with balkanizing an electrical system that has been designed over the better part of a century based on industry standard electrical design and operational considerations—not political boundaries associated with the types of governmental agencies that might be the potential buyers/operators of portions of the system. If PG&E's system were to be broken up into smaller systems that would be contiguous based on defined political boundaries, it is almost certain that a sizeable number of customers that would fall within a given governmental agency's area are currently served by upstream facilities located in one or more other governmental agencies' areas. The reverse is also true. The costs and complexity of investing in new somewhat duplicative facilities and redesigning circuits in order to untangle this web are likely to be enormous, and to take a considerable amount of time. There is also the possibility that municipalities could pursue condemnation of only those parts of PG&E's system with relatively lower wildfire or other safety risks, leaving remaining customers with a smaller PG&E that has less capacity to manage its remaining risks.

PG&E pays substantial amounts in state and local taxes, including most prominently income and property taxes—which a government utility does not pay. In addition, IOUs pay

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domain property outside its limits is expressly granted by statute or necessarily implied as an incident of one of its other statutory powers").

51 *See* Cal. Const. Art. I § 19; Cal. Code Civ. Proc. § 1263.310 ("The measure of this compensation is the fair market value of the property taken.").

52 Filsinger Energy Partners, *supra*, at 15.

53 Synapse Energy Economics, *supra*, at 2.

(footnote continued)

franchise fees. Collectively, property taxes and franchise fees represent an important revenue stream to local governments for a variety of different services. While property taxes might be replaced through a payment in lieu of taxes (PILOT), that is not the case for income taxes. Moreover, PILOT fees can be challenged.[54]

A potential government takeover also would result in numerous other complex legal issues. These would include the status of labor contracts and the effect on supply and other commercial contracts, among others.

17. Should PG&E be a "wires-only company" that only provides electric distribution and transmission services with other entities providing generation services? If so, what entities should provide generation services?

PG&E supports consideration of Proposal 17. PG&E is the owner and operator of the Diablo Canyon Power Plant (DCPP), as well as an additional 66 hydroelectric, 3 natural gas fired, 3 fuel-cell, and 13 solar power plants. PG&E's top risks associated with providing generation services include a core-damaging event or extended safety shutdowns, for DCPP; a large uncontrolled water release, for its hydro units; and an extended safety shutdown, for its natural gas-fired plants. There are no direct, public safety risks associated with PG&E's Energy Policy and Procurement organization, which is responsible for procuring energy, capacity, and ancillary services from third-party generation. Given that generation services carry unique risks, the potential benefit of a wires-only company would be that, by reducing the total number of risks managed by PG&E, it could lead to better management of the remaining risks. The Commission would need confidence that the entity or entities assuming operations would manage risk as well or better, or overall public safety risk would not improve.

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[54] *See Citizens for Fair REU Rates v. City of Redding*, 6 Cal. 5th 1, 12 (2018) (noting that "[t]he critical question is whether REU's rates themselves exceeded its reasonable costs of providing electricity" and concluding in that case the rate was reasonable); *see also Howard Jarvis Taxpayers Ass'n v. City of Roseville*, 97 Cal. App. 4th 637, 647 (2002), *as modified on denial of reh'g* (May 13, 2002) (striking down a PILOT fee intended to approximate the revenue the city received from private utilities for franchises).

Implementing Proposal 17 would pose several challenges and take considerable time to implement. For example, certain generation assets of PG&E, such as the DCPP and its decommissioning trust, may not be salable. PG&E also owns the Humboldt Bay Generating Station, which is a reliability asset that is effectively bundled with transmission assets. Additionally, since becoming a "wires only" company would require that PG&E no longer have an obligation to provide energy supply as the provider of last resort, it would need to be relieved of all going-forward procurement responsibilities, and transition its existing contracts. Finally, another entity, or entities, would need to step in to take on the provider-of-last-resort obligation. The Commission would need to coordinate with the Legislature in order to amend, for example, California Public Utilities Code § 366.2(a)(3).

V. RETURN ON EQUITY

18. Should the Commission condition PG&E's return on equity on safety performance?

PG&E is open to continuing to consider conditioning a portion of its return on equity on safety performance. This is consistent with NorthStar's recommendation that the Commission "[c]consider the implementation of a performance-based ratemaking mechanism with a fixed component based on traditional ratemaking principles and a variable adder based on safety performance."[55] As stated in PG&E's testimony in the earlier phase of this proceeding,[56] PG&E supports the consideration of variable adders—often referred to as targeted performance mechanisms—and believes that a discussion of such a mechanism in the 2020 GRC would allow for thorough evaluation and consideration by the Commission. In its 2020 GRC testimony,[57] for instance, PG&E has proposed an earnings adjustment mechanism (EAM) based on the Utility's performance on several key public and employee safety metrics that would place $30 million of

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[55] NorthStar Report at VII-21.

[56] I.15-08-019, PG&E Safety Culture and Governance OII Prepared Testimony at 2-23 (Jan. 8, 2018).

[57] A.18-12-009, Ex. 12, Ch. 14 (Dec. 13, 2018).

revenue at risk annually over the three-year period of the 2020 GRC. The EAM would be tracked against a weighted set of safety metrics, with public safety metrics comprising 80% and employee safety metrics comprising 20%. The 80% for public safety is distributed evenly between gas and electric operations. However, PG&E remains cognizant of the need to design any such mechanism in a manner that does not discourage safety reporting.

19. What are the safety considerations for the utility if its financial status is downgraded by the investment community?

PG&E recognizes the importance of restoring its investment grade credit rating so that it can raise capital, both debt and equity. This is critical for PG&E to meet its obligation to customers and its operational and safety needs.

VI. OTHER PROPOSALS

20. What other measures should be taken to ensure PG&E satisfies its obligation to provide safe service?

PG&E proposes consideration of reforms to legal liability for utilities arising from wildfires, including inverse condemnation. A utility's ability to provide safe and reliable service to its customers is inextricably linked to its financial health, and the current levels of wildfire risk in California have significantly impaired the financial health of utilities across California. These wildfire risks, coupled with the existing wildfire liability regime for IOUs, have created an environment in which no utility can remain financially viable while providing electricity in a service area that includes significant Tier 3 fire-risk exposure, and the utility can be held strictly liable even if all compliance obligations have been met. None of the structural reform proposals under consideration in this proceeding will change that financial reality.

California remains one of the only states in the country that applies strict liability inverse condemnation to IOUs. Reforming inverse condemnation liability is critical to ensuring that utilities in California are able to continue providing safe, reliable, and financially viable electric

service to customers.[58] As with other proposals under consideration, such reforms would require coordination with the Legislature.

PG&E also proposes that the Commission work with the Legislature to develop a state insurance program for wildfire risk. This kind of state fund would provide fast and certain compensation for those affected by all wildfires, not just those associated with IOU equipment. At the same time, it would permit stable, reliable, and affordable service to high-risk areas. There is also the potential for the Legislature, local governments, and other state agencies to address a variety of related policy areas, including building codes and forest management practices.

As these and other proposals require legislative action, PG&E urges the Commission to continue working collaboratively with the Legislature to evaluate and advocate for these reforms to inverse condemnation liability, a state insurance fund, and other legal and policy changes, both through the Blue Ribbon Commission, and directly with the Legislature.

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[58] *See* Katherine Greig et. al., *Wildfire Costs in California: The Role of Electric Utilities*, Wharton School Risk Management and Decision Processes Center: Issue Brief, 9–12 (August 2018), available at https://riskcenter.wharton.upenn.edu/wp-content/uploads/2018/08/Wildfire-Cost-in-CA-Role-of-Utilities-1.pdf.

VII. CONCLUSION

PG&E welcomes recommendations from parties and commits to considering further changes to its management, governance, and structure that could further improve its safety performance.

Respectfully Submitted,

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